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P&C Financial Reporting Considerations With Respect to COVID-19

Frequently Asked Questions (FAQs) by the Appointed Actuary

One of the goals of the Committee on Property and Liability Financial Reporting (COPLFR) is to educate and provide information to actuaries on current and emerging issues pertaining to property and liability financial reporting. A good example is the annual practice note on Statements of Actuarial Opinion on P/C Loss Reserves. To that end, we thought it would be helpful to compile FAQs on financial reporting topics pertaining to COVID-19.

We expect this to be the first installment of these FAQs as the situation pertaining to COVID-19 evolves and updates may be needed over time. We encourage interested stakeholders to reach out to us through casualty@actuary.org so that we may consider your questions in subsequent releases during the course of the year and beyond.

Kathy Odomirok
Chairperson, COPLFR

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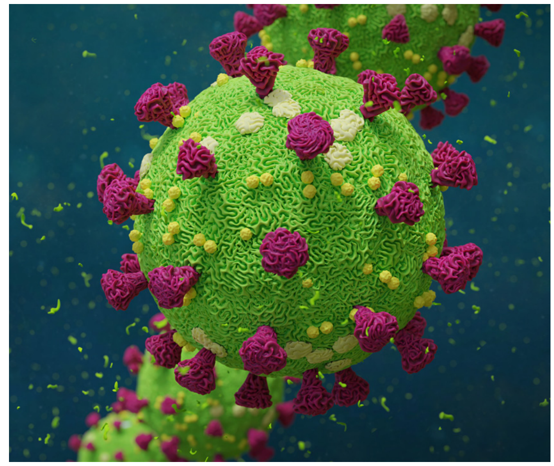

P&C FINANCIAL REPORTING CONSIDERATIONS WITH RESPECT TO COVID-19

Frequently Asked Questions (FAQs) by the Appointed Actuary

This document was developed by the Committee on Property and Liability Financial Reporting (COPLFR) of the American Academy of Actuaries to assist appointed actuaries as they contend with the various uncertainties and challenges pertaining to loss reserving in light of the coronavirus (COVID-19) pandemic and related financial and regulatory developments. COPLFR began compiling questions in April 2020. However, impacts of COVID-19 remain fluid at the time of publication, and the full impact of the pandemic will not be known for years. The FAQ will be updated periodically throughout 2020 to reflect new information as it emerges.

We appreciate the opportunity to respond to financial reporting questions that property and casualty (P&C) actuaries may have on this topic. Please write to casualty@actuary.org and we will consider additional questions in the periodic updates.

We stress that these questions and responses should not be considered alone in making decisions with respect to the impacts of COVID-19. For example, consultations with company managements, boards of directors, regulators, and independent auditors should be considered, as deemed necessary.

1. RECORDED LOSS & LOSS ADJUSTMENT EXPENSE (LAE) RESERVES AS OF DECEMBER 31, 2019

Q. COVID-19 was not declared a pandemic until March 11, 2020. Could there be any impact of COVID-19 on P&C claims incurred in 2019 and prior (in other words, the adequacy of loss and LAE reserves as of December 31, 2019)?

A. The short answer is yes. There are many issues arising from COVID-19 that could impact the duration and severity of claims incurred by a P&C insurer on or before December 31, 2019. These include:

- A number of states have issued directives to stay at home; therefore, many courts and arbitration systems are closed, potentially limiting the ability to report claims and affecting an insurer's ability to settle claims.
- There could exist early settlement opportunities for claims in lines like automobile liability or general liability that otherwise would have been tied up in the court system generating expenses. Claimants could have the immediate need for cash in light of rising unemployment.
- There is the potential for delayed medical treatment and/or physical therapy appointments, potentially limiting an insurer's ability to improve outcomes for claimants.
- Unemployment has been increasing significantly, limiting the ability for injured workers to return to work.

While not exhaustive, these provide some examples of potential impacts of COVID-19 on unpaid claims as of year-end 2019.

2. REQUIRED DISCLOSURES REGARDING THE OPINION ON LOSS AND LAE RESERVES AS OF DECEMBER 31, 2019

Q. I issued a 2019 Statement of Actuarial Opinion and Actuarial Opinion Summary prior to COVID-19 being declared a pandemic by the World Health Organization on March 11. My range of unpaid claims and conclusion with respect to the reasonableness of the Company's recorded loss and LAE reserves gave no consideration to any impact from the infectious disease or ensuing economic environment on loss and LAE reserves for claims occurring on or before December 31, 2019. As the appointed actuary, do I have any obligations pertaining to my prior Opinion?

A. There are several considerations in response to this question.
First, if an Actuarial Report has not been issued, the National Association of Insurance Commissioners (NAIC) Instructions to the P&C Statement of Actuarial Opinion say, "The Actuarial Report should be consistent with the documentation and disclosure requirements of ASOP No. 41, Actuarial Communications. Section 3.4.6 of ASOP No. 41 requires the Actuary to "disclose any relevant event that meets the following conditions:

a. It becomes known to the actuary after the latest information date;[1]

b. It becomes known to the actuary before the report is issued;

c. It may have a material effect on the actuarial findings if it were reflected in the actuarial findings; and

d. It is impractical to revise the report before it is issued."[2]

Such events are defined in ASOP No. 41 as "Subsequent Events." COVID-19 would be considered a Subsequent Event in the Actuarial Report supporting the Opinion if the event could have a material effect on the actuarial findings. The findings not only include the opinion on both gross and net loss and LAE reserves, but also include other reserves for which the actuary is expressing an opinion, such as P&C Long Duration Contracts, findings regarding risk of material adverse deviation, and considerations regarding the collectability of reinsurance, among others. For example, the event can have an impact on the asset side of the balance sheet that could impact a company's surplus position and the determination of the actuary's materiality standard for the purpose of assessing the risk of material adverse deviation (RMAD).

The impacts of COVID-19 are currently not fully known. If the appointed actuary determines that COVID-19 may have a material effect on the actuarial findings should it be reflected in the actuarial findings and the other criteria for a Subsequent Event in ASOP No. 41 are met, a disclosure is required.

An appointed actuary will likely hold discussions with company management to confirm that the appointed actuary's assessment is in alignment with management's evaluation of the impact on the recorded reserves as of December 31, 2019. Management is being asked by state regulators and rating agencies to address the operational and financial impacts of COVID-19. An appointed actuary would likely consider disclosures made by management to external parties with respect to the impact on the year-end 2019 reserves and/or risk of material adverse deviation.

If the appointed actuary has already issued the Actuarial Report but deems the event to have a material impact on the 2019 Statement of Actuarial Opinion, the appointed actuary will likely hold discussions with company management to determine communication and disclosure to the company's board of directors and regulator.

1 Information date is defined in section 3.4.5 of ASOP No. 41 as "the date(s) through which data or other information has been considered in developing the findings included in the report."
2 [Actuarial Standard of Practice NO. 41]

3. REISSUANCE OF THE 2019 STATEMENT OF ACTUARIAL OPINION

Q. Do I need to reissue the 2019 Statement of Actuarial Opinion if the impact of COVID-19 could be material to the loss and LAE reserves as of December 31, 2019, my conclusion with respect to RMAD, my opinion on any other reserve balance, or considerations contained therein?

A. Based on a strict reading of the NAIC Instructions for P&C Statements of Actuarial Opinion, the answer iseems to be "no." Amendments to the Actuarial Opinion generally occur when the opinion was in error as a result of reliance on data or other information (other than assumptions) that, as of the balance sheet date, was factually incorrect and the opinion would not have been issued or would have been materially altered had correct data/information been used. The NAIC Instructions to the P&C Statement of Actuarial Opinion state, "The Actuarial Opinion shall not be considered to be in error if it would have been materially altered or not issued solely because of data or information concerned events subsequent to the balance sheet date or because actual results differ from those projected."

However, if the appointed actuary deems the event to have a material impact on the 2019 Statement of Actuarial Opinion, the appointed actuary will likely hold discussions with company management to determine communication and disclosure to the company's board of directors and regulator.

4. DIFFERENCES BETWEEN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) AND STATUTORY ACCOUNTING PRINCIPLES (SAP) AUDIT FINDINGS

Q. Hypothetically, a GAAP audit was performed and filed prior to COVID-19 being declared a pandemic. While the statutory Annual Statement was filed by March 1, 2020, the statutory audit has not yet been finalized. Could there be a different conclusion with respect to the loss and LAE reserves on a GAAP versus SAP basis as of December 31, 2019, in light of this subsequent event?

A. In general, we believe that it is conceivable that the conclusion with respect to the reasonableness of loss and LAE reserves could be different on a GAAP versus SAP basis. We expect that this would result in considerations as to the need for restatement on a GAAP basis.

While the determination of the audit opinion is made by a certified public accountant (CPA) and not an actuary, it is always possible that the results could be different given additional information obtained between the audit dates. Companies are required to consider subsequent events through the date the financial statements are, or are available to be, issued. Under U.S. statutory accounting, specifically Statement of Statutory Accounting Principle (SSAP) No. 9, COVID-19 would be considered a Type II—Nonrecognized Subsequent Event. While not recorded in the financial statements, material Type II events are to be disclosed in the notes to the financials. SSAP No. 9 goes on further to say that consideration should be made for supplementing financials with pro forma data as if the event had occurred on the balance sheet date. SSAP No. 9 is available in Appendix IV of the 2019 COPLFR Practice Note on P&C Statements of Actuarial Opinion.

In these situations, consultation can be appropriately sought with an independent auditor.

5. IMPACTS ON ACCIDENT YEAR 2020 ESTIMATES

Q. Our Plan Loss Ratio for accident year 2020 contemplated business as usual; however, I work for a personal auto writer and my company has observed significant decreases in claim frequency as a result of the shutdown of nonessential businesses and stay-at-home orders from state and local governments. While governments are talking about a reopening of the economy, the infectious and economic impacts of COVID-19 may continue through the remainder of the year. Should I revise our Plan Loss Ratio and therefore reserve accrual for accident year 2020?

A. The answer is that it depends on numerous factors and claim frequency should not be viewed alone. Factors for consideration include:

a. **How long the virus persists and impacts our economy:**
While this economic downturn is different than any others we have seen in the past, recall the impact on personal auto claim frequency after the 2008 recession. Once the economy picked up and individuals returned to work, claim frequency was on the rise. While the short-term impact on personal automobile claim frequency is obvious (there are very few cars on the road) and we are seeing rebates, the impact on frequency for the remainder of the year upon which the plan was built is not known.

b. **Underlying exposures written and potential expansion of coverage:**
For example, some insurers are expanding coverage to personal automobiles being used in delivery services during the crisis.

c. **Impacts on claim severity:**
While claim settlements may be on the rise given an individual's need for cash in the short term, there could be heightened pressure on claim severity due to factors such as social inflation and social justice, pressure on medical care costs, delays in shipment of car parts and pressures on pricing, as well as increases in serious injuries and fatalities due to high-speed accidents resulting from fewer cars on the road.

d. **Impacts on premium revenue stream:**
For example, many personal auto carriers are providing rebates and discounts which, depending on how they are accounted for, may impact the denominator in the loss ratio projections. These and other factors impacting premiums are considered in actuarial projections.

e. **Collectability considerations across all aspects of the business, including direct written premium and reinsurance ceded**

This list is not exhaustive but demonstrates the number of factors for assessing the impact of COVID-19 to Plan Loss Ratios and reserving decisions made in 2020. One thing is for certain, the 2020 diagonal will provide significant challenges for reserving actuaries.

6. ESTIMATES OF ULTIMATE LOSS RELATING TO THE PANDEMIC

Q. My company writes workers' compensation insurance for employers in the category of first responders and health care workers, and we have already received reported workers' compensation claims related to contracting COVID-19 on the job. Our claims department is in the process of determining coverage. Do I need to establish a reserve for unpaid COVID-19-related workers' compensation claims in the quarterly financial statements?

A. U.S. GAAP and SAP are fairly consistent in terms of whether a loss contingency is recorded by a charge to income. In general terms a contingency is recorded when two conditions are met: the loss is probable and reasonably estimable.

On a statutory basis, we look to SSAP 5R paragraph 8, which indicates that an estimated loss from a loss contingency shall be recorded by a charge to operations if both of the following conditions are met:

8.a. Information available prior to issuance of the statutory financial statements indicates it is probable that a loss has been incurred; and

8.b. The amount of loss can be reasonably estimated.

If a loss contingency is not recorded because only one of the conditions are met, disclosure is required in the statutory financials when there is at least a reasonable possibility that a loss may have been incurred. The disclosure shall give an estimate of the possible loss or range and that such an estimate cannot be made.

Under U.S. GAAP, loss contingencies are categorized under three terms based on the likelihood of occurrence:

- Probable—If it is probable that a loss will result from a contingency and the amount can be reasonably estimated, the estimated loss is accrued. If a range is determined and there is no better estimate, the minimum should be accrued.
- Reasonably possible—A contingency that falls short of either but not both of the parameters requiring an accrual for a probable liability. In this case, disclosure is required similar to SSAP 5R.
- Remote—Potential claims from remote contingencies typically do not possess characteristics requiring disclosure.

So, the first consideration is whether the loss is probable. Generally, two tests must be satisfied for an illness to be compensable under workers' compensation:

1. The illness must be "occupational," meaning it arose out of and in the course and scope of the employment; and
2. The illness must arise out of or be caused by conditions specific to the work (e.g., black lung in the case of the coal mining industry).

Flus, colds, and other infectious diseases are generally not considered to be compensable occupational illnesses that arise out of and in the course of employment. These are common public risks whereby exposure could occur anywhere. Therefore, causation between the illness and workplace is difficult to establish within a reasonable degree of medical probability.

However, in the case of health care workers and first responders, the connection between COVID-19 and employment may be easier to establish given the scope of work. Some states have proposed bills and/or issued executive orders regarding presumption of risk. For example, California Gov. Gavin Newsom signed an executive order on May 6, 2020, to provide California's essential workers with presumption benefits for COVID-19.

Even so, a number of states have imposed, and some health insurers voluntarily have offered, to waive copays and costs for testing, as well as emergency room, doctor, and urgent care visits. As such, certain of the initial medical care costs may be covered by health insurance. Further, there are additional questions that arise with respect to recovery time. Will time away from work to recover from the virus be considered a typical "sick leave" benefit of employment, or a disability benefit under workers' compensation?

Even if certain losses for certain industries are probable, the question becomes whether the losses are estimable given the information currently available.

The following is a list of factors that might be considered by the actuary in preparing an estimate in this situation:

- The number of essential employees insured by industry type
- Expected percentage exposed to the virus
- Probability that exposure relates to occupation
- Of those exposed, what percentage:
    - Are quarantined at home
    - Require hospital care and level of such care
    - Die from the virus
- Demographic characteristics of the impacted workers; e.g., age
- Benefits provided as part of regular employee sick leave, health insurance, or workers' compensation
- Associated medical costs and benefits, including rehabilitation
- Potential increases in premium estimates (payroll) due to demands for essential workers

7. IMPACTS OF MORATORIUM ON POLICY CANCELLATIONS BY STATE GOVERNMENTS AND/OR SLOWDOWN OF PREMIUM PAYMENTS

Q. We are seeing state governments issuing orders that prevent insurers from canceling or non-renewing policies, allowing insureds to pay premiums over a 12-month period (e.g., forbearance). What impact does this have on the earning of premium?

A. The following provides potential considerations with respect to earned premium in light of COVID-19:

- The adequacy of unearned premium reserves (UPR) and whether a premium deficiency is required for incurrals related to COVID-19 based on higher loss costs and potentially lower premium volumes. Lines impacted may include travel insurance, trade credit, workers' compensation, and property insurance if there are covered business interruption claims.

- Estimates of Earned But Unbilled (EBUB) Premiums: EBUB includes estimated adjustments that occur on policies where the premium is dependent upon audit of exposures, such as payroll for workers' compensation policies. Actual payroll is not known until after the policy has expired. EBUB premiums are recorded if they are reasonably estimable in the aggregate. For certain industries, forecasts of payroll used in the determination of written premium tend to underestimate actual payroll in periods of economic growth and to overstate in periods of economic decline. Estimates of EBUB could likely result in return of premiums given the current economic situation, resulting in an increase in the UPR need, unless policy endorsements are issued resulting in reduced exposure. We also note that the demand for essential workers may result in payroll increases for this cohort of insureds and therefore result in an increase in premium.
- The impact of premium rebates and refunds: Premium rebates/refunds initiated by some insurance carriers (e.g., personal auto writers) may also impact the earning of premium and UPR, depending on how they are accounted for in a company's financial statements.
- Estimates of ultimate premiums used in the determination of earned and UPR may be impacted. An example is reinsurance of mortgage portfolios, where the ultimate premium is dependent upon an estimate. Potential increases in default rates emerging from economic conditions could impact ultimate premium estimates depending on the probability of default and timing factored into the original estimate.

These are only examples of potential considerations. From a presentation perspective, it is also important to remember that Schedule P, Part 1 provides earned premiums by calendar year. Once they are entered in Schedule P, Part 1, they do not change for premium adjustments. Premium adjustments are recorded in the year they are made. Such adjustments are recorded in Schedule P, Part 6. Typically, the actuary will consider this when evaluating historical loss ratios in Annual Statement filings. It could result in a significant mismatch between incurred loss experience relative to the exposure in the calculated loss ratios shown in Schedule P.

8. CONSIDERATIONS WITH RESPECT TO DELAYS IN COLLECTING PREMIUMS (I.E., CREDIT RISK)

Q. Not only will there be delays in payment of premium, but I expect there to be heightened credit risk and risk of nonpayment given the economic consequences of COVID-19. As a reserving actuary, what should I be thinking about with respect to delays or nonpayment of premium?

A. Premium estimates are key to the determination of ultimate loss and expense ratios for planning, pricing, and reserving purposes. Consideration is made, not only for the reduction in risk due to businesses being shut down and fewer cars on the road, but also for the reduction in premium due to rebates, risk of non-payment and reduced exposures.

Premiums that are more than 90 days due are considered nonadmitted assets under statutory accounting. Further, an insurer may determine that agents' balances that are 90 days overdue are unlikely to be collected (or "impaired"). In those situations, the insurer would typically establish an allowance for bad debts. This will impact a company's surplus, which will in turn impact risk-based capital ratios, Insurance Regulatory Information System (IRIS) Ratios, and other tools used to assess the financial health of an insurance company.

We note that the NAIC Statutory Accounting Principles Working Group has recently released INT 20-02: "Extension of Ninety-Day Rule for the Impact of COVID-19," which was approved by the Working Group on April 15, 2020, and is working its way through the NAIC process toward final approval. This change allows for a one-time extension of the 90-day rule for premiums and agents balances, as described in INT 20-02.. This extension is applicable for the March 31, 2020, and June 30, 2020, financial statements for the specific categories of assets defined within INT 20-02.

9. PREMIUM REBATES AND DISCOUNTS

Q. My company is returning auto insurance premium and providing discounts on future premiums. How should I consider this for purposes of estimating ultimate loss and expense ratios?

A. There are several ways refunds may be issued to policyholders. GEICO announced 15% credit to auto policyholders upon renewal and for new business during the six-month period beginning April 8. American Family and Nationwide announced a one-time dollar rebate to customers. Allstate is returning 15% of April and May premiums. These are just examples based on recent announcements. In addition to discounts, rebates, and refunds, companies might be also considering issuing dividends.

With respect to loss and expense ratios, consideration depends on the accounting for the type of discount or refund (e.g., as an adjustment to premium or other form). Regardless, care is appropriately taken by actuaries when evaluating loss and expense ratios for the current accident year (2020) versus prior accident years, as there will likely be a mismatch not only due to exposure, but also due to premium adjustments.

10. CONSIDERATIONS WITH RESPECT TO RESERVING IN 2020 AND BEYOND

Q. What are some considerations I need to think through with respect to reserving in 2020?

A. Actuaries need to think through adjustments to their reserving methodologies as they weigh the impacts of the infection and economy on the loss experience during 2020. Some considerations include:

- Changes in loss development patterns that may emanate from:
  - Delays in reporting and therefore claim settlement patterns as a result of the shutdown
  - Acceleration of claim settlement due to digital reporting and remote claims handling
  - Increased settlement activity due to unemployment and the need for cash
  - Clearing of backlogs
  - Impacts of reductions in claim staff
  - Changes in case reserving adequacy
- Initial expected loss ratio or loss cost assumptions in light of changes to exposures and premium balances. Potential considerations include:

- Reduction in risk and exposures in certain lines due to businesses being shut down and fewer automobiles on the road
    - Reduction in premium due to rebates/refunds, risk of nonpayment, and reduced exposures
    - Increase in risks, exposures, and premiums for certain lines involving essential workers
    - Impacts of accounting for premium rebates/refunds on the current loss ratio
    - Appropriateness of reliance on history for purposes of on-level loss ratio/cost assumptions in the current environment
- Determination of the expected losses for purposes of assessing actual versus expected emergence in 2020 will need to consider a change in the loss development patterns
- Economic impacts on cost of claims
    - Demands for health care and medical supplies on the rise
    - Demands for health care decline or are postponed due to concerns regarding COVID-19 infection
    - Slowdown in the economy and impacts on the cost of goods and indemnity payments
    - Potential long-term cost savings through telemedicine, increased utilization of electronic monitoring of health patient conditions
- Impacts of morbidity on run-off books of workers' compensation, lifetime personal injury protection, and/or asbestos and environmental claims
- Changes in LAE costs, which may be impacted by:
    - Lower claim frequency and reductions in workforce
    - Reduction in attorneys fees due to increased settlements
- Reinsurance collectability
- Lags in salvage and subrogation recoveries or possible changes in salvage values (increase or decrease) given the slowdown in the economy

Academy Offers Resource Page on Coronavirus Pandemic Information
The Academy has created a webpage with resources for the ongoing coronavirus (COVID-19) pandemic. The page includes resources such as links to the Centers for Disease Control and Prevention (CDC) and World Health Organization (WHO), the Centers for Medicare & Medicaid Services (CMS) regulatory activity and other legislative and regulatory actions, pertinent articles, and more. The Academy will continue to add resources to this freely available webpage as more information becomes available.

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